Appendix A

No. C-79-2146 SC

United States District Court
Northern District of California

EMI Limited,
Plaintiff,

vs.

William M. Bennett, et al.,
Defendants.

[Filed October 8, 1982]

ORDER GRANTING MOTION TO DISMISS

This case is before the court on defendants' motion to dismiss for lack of subject matter jurisdiction. The case has a lengthy history. Plaintiff EMI Limited ("EMI"), a United Kingdom corporation that does no business in California, is the parent corporation of Capitol Industries-EMI, Inc. ("Capitol"), a Delaware corporation with its principal place of business in California. Defendants are members of the California Franchise Tax Board.[1] In separate but related actions EMI and Capitol challenged the tax deficiency assessed against Capitol by the Franchise Tax Board. The assessment was made according to California's unitary method. *See* Cal. Rev. & Tax. Code §§ 25101, 25120-25138. The district court granted summary judgment in both cases in favor of defendants pursuant to 28 U.S.C. § 1341 (anti-injunction statute) on the ground that EMI and Capitol had a plain, speedy, and adequate state law

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[1]The current members of the Franchise Tax Board have been substituted as defendants. *Capitol Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107, 1111 n. 8 (9th Cir. 1982).

remedy. On appeal, the Court of Appeals for the Ninth Circuit ordered that Capitol's action be dismissed for lack of subject matter jurisdiction. In addition, it reversed the judgment against EMI and remanded for further proceedings. *Capitol Industries-EMI, Inc. v. Bennett,* 681 F.2d 1107 (9th Cir. 1982). Pursuant to a suggestion made by the Court of Appeals, *id.* at 1119 n. 31, defendants have now moved to dismiss for lack of standing, and generally for lack of subject matter jurisdiction.

EMI alleges that computation of Capitol's tax according to California's unitary method violates the United States Constitution and the United States-United Kingdom Income Tax Convention. No assessment has been made against EMI, only against Capitol. EMI alleges that the assessment injures it because, as majority shareholder, the value of its investment will decrease if Capitol must pay the tax. EMI also alleges that the Franchise Tax Board has requested it to supply certain information and has threatened to assess a penalty against it if it does not.

Although an injury to a corporation may indirectly harm a shareholder by decreasing the value of his shares, that fact does not give the shareholder standing to sue on his own behalf. The primary injury and the primary right to sue are the corporation's; the shareholder may sue, if at all, only in a proper derivative action. *Von Brimer v. Whirlpool Corp.,* 536 F.2d 838, 846 (9th Cir. 1976); *Erlich v. Glasner,* 418 F.2d 226, 227-28 (9th Cir. 1969); *Papilsky v. Berndt,* 466 F.2d 251, 255 (2d Cir.), *cert. denied,* 409 U.S. 1077 (1972); *Jensen v. Voyles,* 393 F.2d 131, 133 (10th Cir. 1968). Therefore, EMI's claim of dimunition of its investment is not sufficient to confer standing.

EMI also claims that the tax violates the United States-United Kingdom Income Tax Convention. The provisions EMI relies on set forth conditions under which United Kingdom corporations and their subsidiaries may be taxed in the United States. The treaty does not help EMI here. EMI is not being taxed, and the provisions regarding taxation of subsidiaries create rights, if at all, only in favor of Capitol. The treaty makes no mention of a right of action by a shareholder as such.

EMI asserts that the demands for information made by the Franchise Tax Board support standing. To show that such demands were made, EMI relies primarily on a letter received from the Board stating what information it needed. EMI claims that the Board does not have jurisdiction over it and that under United Kingdom law it cannot supply the information.

It must be noted at the outset that the demands for information would not necessarily support standing to challenge the tax assessed against Capitol, but perhaps only a more limited standing to challenge the Board's right to obtain information from EMI. Further, the Court of Appeals determined that the demands for information were addressed to Capitol, not EMI. *Capitol Industries-EMI, Inc. v. Bennett,* 681 F.2d at 1119 n. 30. The record on appeal contained essentially the same information EMI now relies on.[2] Affidavits before the Court of Appeals discussed the information requests allegedly made of EMI and the specific letter EMI relies on here. EMI may not continue to

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[2]On a motion to dismiss for lack of subject matter jurisdiction it is proper to look to matters outside the pleadings. *Id.* at 1118 n. 29.

make the same assertions on the same evidence. Therefore, the alleged information demands do not support standing.

In sum, neither EMI's status as controlling shareholder of Capitol nor the United States-United Kingdom Income Tax Convention confer standing to challenge the tax assessed against Capitol. The asserted demands for information also do not support standing, even for more limited claims. Therefore, this court lacks subject matter jurisdiction.

In accordance with the foregoing, it is hereby ordered that defendants' motion to dismiss for lack of subject matter jurisdiction is granted.

Dated: October 8, 1982.

/s/ SAMUEL CONTI
United States District Judge

Appendix B

No. 80-4113

DC No. C79-2145-CBR

In the United States Court of Appeals

For the Ninth Circuit

Capitol Industries-EMI, Inc.,

Plaintiff-Appellant,

vs.

William M. Bennett, Kenneth Cory, Richard Silberman, individually and as members of, and Martin Huff, individually and as Executive Officer of, The Franchise Tax Board, State of California,

Defendants-Appellees.

No. 80-4114

DC No. C79-2146-CBR

EMI Limited,

Plaintiff-Appellant,

vs.

William M. Bennett, Kenneth Cory, Richard Silberman, individually and as members of, and Martin Huff, individually and as Executive Officer of, The Franchise Tax Board, State of California,

Defendants-Appellees.

OPINION

[Filed Feb 16, 1982]

On Appeal from the United States District Court

For the Northern District of California

Charles B. Renfrew, District Judge, presiding

Argued and Submitted October 15, 1981

Before: WALLACE and PREGERSON, Circuit Judges, and BYRNE,* District Judge

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*The Honorable Wm. Matthew Byrne, Jr., United States District Judge for the Central District of California, sitting by designation.

BYRNE, District Judge:

This appeal involves two companion cases brought by an United Kingdom corporation and its United States subsidiary corporation, respectively, for injunctive and declaratory relief to prevent officials of the State of California from assessing additional income taxes against the subsidiary.

I

Appellant in the first action (No. 80-4113), Capitol Industries-EMI, Inc. ("Capitol"), is a Delaware corporation, with its principal place of business in California. Capitol is in the business of recording phonograph records and tapes for sale through commercial channels. Capitol contends that its business is conducted almost exclusively in the United States.

Appellant in the second action (No. 80-4114), EMI, Limited ("EMI"), is a United Kingdom corporation, which owns more than 70% of the stock of Capitol.[1] EMI owns a group of subsidiaries, fourteen of which operate outside of the United Kingdom. EMI, through its subsidiaries other than Capitol, is engaged in the same business as Capitol, but primarily in markets other than in the United States. In addition, EMI and its foreign subsidiaries, other than Capitol, are engaged in diversified businesses unrelated to the recording industry.

In the seven years involved in this tax dispute, 1968-1974, Capitol has paid annual income taxes in California.[2] Neither EMI nor its subsidiaries, other than Capitol, have filed

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[1]According to appellees, EMI owns more than 70% of the stock of Capitol. According to appellants, EMI owns more than 90% of the stock of Capitol.

[2]In the seven years involved in this dispute, Capitol has made annual self-assessed state franchise tax payments averaging $88,841.68.

any income tax returns with the United States or any state therein. However, EMI and its other subsidiaries have paid income taxes in their respective home countries.

The Franchise Tax Board, State of California ("FTB"), contends that California law requires a combined report of a taxpayer, including all commonly owned or controlled corporations that are engaged in a unitary business. The FTB has determined that Capitol, EMI and other EMI subsidiaries are engaged in a single business. Therefore, the FTB has proposed to assess against Capitol an additional tax liability for the seven years in question, based on the state's "unitary method" of taxation.[3] It is this proposed assessment that Capitol and EMI challenge.

Application of the unitary scheme under California law, as proposed by the FTB, involves the combining of the net incomes of Capitol, EMI, and all of EMI's other subsidiaries, related to the music portion of their businesses, and the apportioning of that combined income between California and the rest of the world, based on a formula using the Cal-

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[3]According to materials submitted by the parties subsequent to oral argument on appeal, the FTB has adjusted the proposed additional assessments against Capitol to reflect its determination that the unitary business in which Capitol and EMI are involved encompasses only the "music activities" of the "EMI group." In addition, the proposed assessments were adjusted to reflect agreements between Capitol and the FTB related to other issues not before this court. As a result of these adjustments, the revised proposed assessments are as follows:

Year	Amount
June 30, 1968	$ 42,171
June 30, 1969	$118,946
June 30, 1970	$207,677
June 30, 1971	$ 0
June 30, 1972	$ 75,527
June 30, 1973	$ 16,827
June 30, 1974	$344,185

ifornia ratio of property, payroll, and sales, to the worldwide figures for the same factors.[4]

In the course of the FTB's investigation of Capitol, demand was made upon Capitol to provide certain business records of EMI, and EMI's other subsidiaries, under the threat that Capitol's failure to comply would result in a penalty assessment. EMI informed Capitol that it would not provide some of the information demanded because, under the Official Secrets Act of the United Kingdom, some of the information (presumably information related to military contracts entered into by EMI and the British government) is not disclosable. EMI refused to provide other information, arguing that it lacked access to such information and that California lacks jurisdiction over EMI and its non-United States subsidiaries.

Capitol filed a protest with the FTB concerning the proposed assessment, which is still pending.[5] In addition, Cap-

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[4]California Revenue and Taxation Code section 25101 provides in part:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of article 2 (commencing with section 25120 of this chapter). . . .

Cal. Rev. & Tax. Code § 25101. Section 25128 provides:

> All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Cal. Rev. & Tax. Code § 25128. Sections 25129 through 25136 define and provide for the computation of the property, payroll and sales factors. Cal. Rev. & Tax. Code §§ 25129-25136.

[5]Section 25664 of the Revenue and Taxation Code provides:

> Within 60 days after mailing of each notice of additional tax proposed to be assessed the taxpayer may file with the Fran-

itol has petitioned the FTB to authorize the use of a reporting scheme other than the unitary method, as applied to the proposed assessment.[6] Subsequent to oral argument on appeal, the FTB denied that petition.[7]

Capitol filed its action in United States District Court against William Bennett, Kenneth Cory, Richard Silberman and Martin Huff ("Board Members"), individually and as members of the FTB.[8] Capitol seeks injunctive and

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chise Tax Board a written protest against the proposed additional tax, specifying in the protest the grounds upon which it is based.

Cal. Rev. & Tax. Code § 25864.

[5]Section 25137 of the Revenue and Taxation Code provides:

If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

a. Separate accounting;

b. The exclusion of any one or more of the factors;

c. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

d. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

[7]Appellees submitted a copy of the Board's resolution, dated October 21, 1981, denying Capitol's Section 25137 petition challenging the subject proposed additional assessment.

[8]Subsequent to oral argument on appeal, appellants filed a Motion for Designation of Substituted Parties, pursuant to Federal Rule of Civil Procedure 25(d). Under Federal Rule of Appellate Procedure 43(c), the substitution of public officials who have succeeded those named as parties occurs automatically. An order of substitution is unnecessary under Rule 43(c) but such an order may be entered at anytime thereunder. Upon the representations of appellants as to the present membership of the FTB and upon

declaratory relief to prevent the proposed assessment. Essentially, Capitol argues that unitary treatment of its business and that of EMI and other EMI subsidiaries is inappropriate under California law and violates the Foreign Commerce Clause of the United States Constitution, Art. I, Sec. 8, Clause 3.[9]

EMI filed its action in federal court against the identical defendants and asserts essentially the same claims as Capitol.[10] Additionally, EMI alleges that the proposed assessment on its subsidiary Capitol would negatively affect its stock holdings in Capitol. Both EMI and Capitol also seek relief from the FTB's demand that Capitol provide certain records of EMI and its foreign subsidiaries.

The Board Members filed motions to dismiss both actions. Capitol and EMI then filed motions for summary judgment. The district court treated the Board Members' motions as motions for summary judgment, pursuant to Federal Rule of Civil Procedure 56. The district court denied Capitol's and EMI's motions and granted the Board Members' motions on the ground that the Anti-Injunction Act precluded subject matter jurisdiction because a "plain, speedy and

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the non-opposition of appellees to the motion for designation of substitution, this Court hereby orders that Mary Ann Graves, Ernest J. Dronnenburg, Jr., and Gerald H. Goldberg, be substituted for Richard Silberman, William M. Bennett, and Martin Huff, as defendants-appellees in these actions, pursuant to Rule 43(c).

[9]In particular, Capitol argues that the proposed assessment is unconstitutional in view of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979), where the Supreme Court held that the Commerce Clause of the United States Constitution prohibited a state from imposing a nondiscriminatory *ad valorem* tax on foreign-owned instrumentalities engaged solely in international commerce.

[10]*See* note 8 *supra*.

efficient" state court remedy existed for the claims asserted by Capitol and EMI. 28 U.S.C. § 1341.[11] Capitol and EMI appeal from that order.

II

Section 1341 provides that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under state law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341.[12] This statute has its roots in equity prac-

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[11]Appellees also contend that the present actions are barred from being brought in federal court by the Eleventh Amendment.

A court should not pass upon a constitutional question, although properly presented by the record, if there is also present a statutory ground upon which the case may be disposed of. *See generally, Wood v. Strickland*, 420 U.S. 308, 95 S.Ct. 992, 43 L.Ed.2d 214 (1975). This principle has varied application, *id.*, and presumably applies where two grounds are presented for defeating subject matter jurisdiction. *See generally* 1 *Moore's Federal Practice* ¶ 0.60[3], at 620-21 (2d ed. 1980). Thus, this court should first consider whether the district court could exercise jurisdiction notwithstanding the proscriptions of the Anti-Injunction Act. If the district court order is affirmed on this ground, this court need not reach the constitutional question presented by the Eleventh Amendment.

[12]The legislative history of Section 1341 reflects two main purposes: First, the section was aimed at eliminating the discriminatory effect on citizens of the taxing state, who can only bring their tax disputes before state courts, while out-of-state corporations could take their disputes into either federal or state court. *See Aluminium Co. of America v. Dept. of Treasury of the St. of Mich.*, 522 F.2d 1120, 1123-24 (6th Cir. 1975); S. Rep. No. 1035, 75th Cong., 1st Sess. 1-2 (1937). Second, the section was intended to eliminate the disruption of state financing efforts by out-of-state corporations. *Id.; see Perez v. Ledesma*, 401 U.S. 82, 128 n.17, 91 S.Ct. 674, 698 n.17, 27 L.Ed.2d 701 (1971) (Brennan, J., concurring in part and dissenting in part); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298, 63 S.Ct. 1070, 1073, 87 L.Ed. 1407 (1943) (*"Great Lakes"*).

The Congressional Record indicates two secondary reasons behind the enactment of Section 1341. First, Congress was concerned

tice, in the principles of federalism, and in recognition of the need of a state to administer its own fiscal operations. *Tully v. Griffin, Inc.*, 429 U.S. 68, 73, 97 S.Ct. 219, 222, 50 L.Ed.2d 227 (1976); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298, 63 S.Ct. 1070, 1073, 87 L.Ed. 1407 (1943) (*"Great Lakes"*). This court has held that Section 1341 also generally bars actions for declaratory relief against the assessment or collection of state taxes. *See Housing Authority of the City of Seattle v. State of Washington*, 629 F.2d 1307, 1310 (9th Cir. 1980);[18] *see also Great Lakes*, 319 U.S. at 300, 63 S.Ct. at 1074. The jurisdictional bar of Section 1341 is not avoided by challenging the constitutionality of the state statute that authorizes the subject assessment or collection. *Mandel v. Hutchinson*, 494 F.2d 364, 366 (9th Cir. 1974) *citing Matthews v. Rodgers*, 284 U.S. 521, 525-26, 52 S.Ct. 217, 219, 76 L.Ed. 447 (1932). The issue here is whether California affords Capitol and EMI a "plain, speedy and efficient" remedy.

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IV

We now turn to the question of whether EMI has an adequate state court remedy.

The administrative procedures and refund suit provided by California law are remedies available only to taxpayers.

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with the added expense of litigating in federal courts that might make it financially unsound for state or local taxing authorities to contest a wealthy corporation's tax liability *See Aluminium Co. of America*, 522 F.2d at 1124, *citing* 81 Cong. Rec. 1416-17 (1937). Second, Congress intended to relieve the congestion in the federal courts by letting state courts settle what were viewed as essentially state controversies. *Id.*

[18] *Accord Aluminum Co. of America*, 522 F.2d 1120; *City of Houston v. Standard-Triumph Motor Co.*, 347 F.2d 194 (5th Cir. 1965), *cert. denied*, 382 U.S. 974 (1966); *Hemsley v. City of Detroit*, 320 F.2d 476, 478 (6th Cir. 1963).

Capitol, and not EMI, is the only California taxpayer involved in this controversy. Therefore, California does not provide EMI with an administrative or judicial remedy to challenge tax assessments.

The district court, however, concluded that EMI's interests in opposing the subject assessment are "identical or substantially identical to that of [Capitol], which does have access to the state administrative agencies and state courts." Thus, the court found the appellants' interests "being identical," EMI has "in effect a plain, speedy and efficient state remedy as to the matters for which it complains." The district court therefore also granted summary judgment in favor of the Board Members and against EMI.

The claims of Capitol and EMI are substantially the same. Both seek to have the Board Members enjoined from imposing the subject assessment and from demanding EMI's business records. The interests of the two corporations, however, are not necessarily identical. Although EMI contends that the proposed assessment would, in effect, constitute a tax on its non-United States business income and that of its other foreign subsidiaries, it is Capitol that would directly have to pay the assessment. Thus, while the harm that Capitol seeks to avoid is the payment of an additional assessment, EMI seeks to avoid a more indirect harm: the diminished return on and value of its stockholdings in its subsidiary corporation, Capitol.[30]

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[30]With respect to the EMI records demanded by the FTB, the interests of the two corporations are not identical. It is clear from the record on appeal that the demand for the subject records was addressed to Capitol and not to EMI. Capitol claims that it lacks access to the records, which it needs in order to succeed in its state administrative and judicial proceedings. EMI argues that its disclosure of some of the records would violate the Official Secrets

No authority has been presented for the proposition that a nontaxpayer, without state administrative or judicial remedies, is precluded under Section 1341 from maintaining an action in federal court because it has substantially similar interests and claims as a taxpayer that has such state remedies. A nontaxpayer that has stated a claim with respect to an assessment or collection is entitled to a judicial remedy in which it can participate as a party. *See Buildings & Developers Corp. v. Manassas Iron & Steel Co.*, 208 F.Supp. 485 (D.C. Md. 1962) (nontaxpayer could invoke federal jurisdiction where state remedy was available only to taxpayer); *see also D.C. Transit System, Inc. v. Pearson*, 149 F. Supp. 18 (D.D.C. 1957) (nontaxpayer could invoke federal jurisdiction), *rev'd*, 250 F.2d 765 (reversed upon reassurances that local remedies would be provided to nontaxpayer); *cf. Pool v. Wash*, 282 F. 620 (9th Cir. 1922) (nontaxpayer had standing to enjoin collection of federal taxes); *Shelton v. Gill*, 202 F.2d 503 (4th Cir. 1953) (same).[31] Because California does not provide EMI with

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Act of the United Kingdom, disclosure of other records is unwarranted because EMI is not within the taxing jurisdiction of California, and, if the records are not made available, it will be indirectly harmed by the additional tax assessment against its subsidiary.

In addition, EMI contends that the proposed assessment would violate the United States-United Kingdom Income Tax Convention because the effect of the assessment is to tax income earned by EMI outside of California, and that it is entitled to a federal court determination of that claim. Capitol, EMI argues, could only claim protection by the Convention as an incidental beneficiary. We do not address the issues raised with respect to the Convention, in view of our ruling as to Case No. 80-4114.

[31]EMI argues that the nontaxpayers in the above cited cases may have had a more direct interest in the proposed assessments at issue than does EMI. Such a distinction may be relevant in determining whether EMI has standing to assert a claim related to the assessment against Capitol or whether it has stated such a claim. The

an effective state remedy for its claims, Section 1341 does not bar the district court from exercising subject matter jurisdiction over such claims.[32]

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issue here, however, is whether a non-taxpaying entity is precluded by Section 1341 from bringing an action related to such an assessment, assuming that the entity has standing and has stated a claim.

There is serious question whether EMI, as a non-taxpayer, has standing to challenge the proposed assessment against its subsidiary corporation, Capitol, or whether it has stated a claim upon which relief can be granted. These issues, however, were not the basis for the district court's order granting summary judgment against EMI. Both issues, and any other grounds for dismissal or summary adjudication not raised on this appeal are appropriate for consideration in the first instance by the district court on remand.

The issue of standing, for example, was not raised expressly on this appeal. The issue of standing may involve factual determinations, which are appropriate for initial determination by the trial court.

Subsequent to oral argument on appeal, appellants moved for leave to file a supplemental memorandum concerning the issue of EMI's standing, We hereby deny that motion.

[32]Allowing a parent corporation to bring an action in federal district court to challenge a state tax assessment against its subsidiary corporation could result in the circumvention of state remedial procedures that Section 1341 was intended to prevent. *See* note 12 *supra*. Moreover, simultaneous federal and state actions involving substantially similar issues clearly are not desirable. California, however, could eliminate both problems by clearly providing a judicial or administrative remedy in which such non-taxpaying entities, which are interested parties and have stated a claim with respect to an assessment, could participate as parties. (Such a remedy might be particularly appropriate where the state is applying the unitary assessment method to a domestic subsidiary and its foreign parent, and where the state is demanding the business records of the foreign parent).

In addition, the problem of circumvention of state procedures and of simultaneous litigations can be minimized by the district court in many cases. For example, where appropriate the district court has authority to stay a federal proceeding brought by an interested non-taxpayer, pending a determination of state administrative and judicial proceedings brought by the taxpayer. The district court also

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Appellees argue that if EMI's action is not precluded by Section 1341, it is barred by the Eleventh Amendment of the United States Constitution.

The Eleventh Amendment bars federal courts from hearing suits "commenced or prosecuted against one of the United States." Appellees contend that EMI's action can only be brought in federal court if the state has waived its Eleventh Amendment immunity to such an action. This argument, however, presupposes that the Eleventh Amendment would otherwise bar that action.

EMI filed its action against state officials, members of the FTB. The Eleventh Amendment does not bar federal court actions against state officials to enjoin them from enforcing unconstitutional statutes. *Ex Parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908) (injunctive action against state attorney general restraining him from enforcing state railroad rate and penalty statute). A suit against state officials is not considered a suit against the state in violation of the Eleventh Amendment where the challenged actions of the officials (1) are beyond the authority granted to them by a valid statute or (2) are performed pursuant to an unconstitutional statute. In both situations, relief can

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may dispose of actions brought by non-taxpayers, either before or after such a stay, where the non-taxpayer lacks standing, is not a real-party-in interest, or has failed to state a claim upon which relief can be granted. *See* note 31 *supra*.

We express no opinion as to whether a stay of Case No. 80-4114 is appropriate in the present circumstances. That determination is left for the Board Members to raise, if they desire, and the district court to consider in the first instance on remand. Among the factors the district court should consider in determining whether to stay such an action, is what imminent harm, if any, EMI would suffer as a result of such a stay.

be granted without interpleading the state. *See Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 689-90, 69 S.Ct. 1457, 93 L.Ed. 1628 (1949); *see, e.g., United States Steel Corp. v. Multistate Tax Commission*, 367 F.Supp. 107, 115 (S.D.N.Y. 1973), *aff'd*, 434 U.S. 452, 98 S.Ct. 799, 54 L.Ed.2d 682 (1978).

The Board Members are charged with acting unconstitutionally by applying the unitary tax method to a domestic subsidiary and its foreign parent. This case falls squarely within the doctrine of *Ex Parte Young*. In such cases, the Eleventh Amendment does not preclude access to the federal courts.

The state, however, will be deemed the real party in interest, for Eleventh Amendment purposes, if a money judgment is sought against defendants, which will have to be paid out of the state treasury. *See Edelman v. Jordan*, 415 U.S. 651, 94 S.Ct. 1347, 39 L.Ed.2d 662 (1945); *Hutchinson v. Lake Oswego School District No. 7*, 519 F.2d 961, 966 (9th Cir. 1975), *vacated on other grounds*, 429 U.S. 1033, 97 S.Ct. 725, 50 L.Ed.2d 744 (1977). Thus, a suit seeking a refund of taxes paid to a state is barred by the Eleventh Amendment even when nominally against state officials. *Ford Motor Co. v. Dept. of Treasury*, 323 U.S. 459, 65 S.Ct. 347, 89 L.Ed. 389 (1945); *Rutledge v. Arizona Board of Regents*, slip op. 5591 at 5596 (9th Cir. Nov. 12, 1981). Although the present action might result in California receiving less tax revenue, EMI seeks prospective injunctive and declaratory relief against state officials, and not a money judgment against the state. Therefore, the Eleventh Amendment is not a bar to EMI's action in fed-

eral court.[33] *Cf. Great Northern Life Insurance Co. v. Reed*, 322 U.S. 47, 64 S.Ct. 873, 88 L.Ed. 1121 (1944) (action against state tax collectors to recover monies wrongfully collected, enforceable by personal judgment); *United States Steel Corp.*, 367 F.Supp. 107 (action to enjoin application by state officials of tax law).[34]

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[33]In *Alabama v. Pugh*, 438 U.S. 781, 98 S.Ct. 3057, 57 L.Ed.2d 553 (1978), the Supreme Court ordered summary dismissal, on Eleventh Amendment grounds, of a mandatory injunction issued against the State of Alabama and the Alabama Board of Corrections, while leaving the injunction intact against officials of the state and board.

[34]The Board Members argue that if Section 1341 or the Eleventh Amendment is not a bar to Case No. 80-4114, the federal courts should abstain from ruling on the issues presented by EMI. The Board Members rely substantially on *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976) (abstention is appropriate where federal jurisdiction is invoked for purposes of restraining the collection of state taxes)."

There is little doubt that the California courts will uphold the unitary tax scheme generally as authorized by state statute. *See, e.g., California Edison Stores, Inc. v. McColgan*, 30 Cal.2d 472, 183 P.2d 16 (1974). It is unclear, however, whether the California courts would uphold the application of the unitary method in the present case. *Compare Chase Brass and Copper Co. v. Franchise Tax Board*, 10 Cal.App.3d 496, 95 Cal. Rptr. 805 (1970) (application of unitary method to foreign operations overruled) with *Firestone Tire & Rubber Co. v. Franchise Tax Board*, Los Angeles Superior Court (No. 31242 1980) (application of unitary tax method to foreign operations upheld).

It may be desirable to allow the state courts to rule on the applicability of California's unitary method in this case before the federal courts consider the constitutional issues presented. In view of this court's ruling that EMI does not have an adequate remedy in state court, however, it would be inappropriate to dismiss Case No. 80-4114 on abstention grounds. Nevertheless, the considerations relevant to the abstention argument may also be relevant to the issue of whether Case No. 80-4114 should be stayed pending a determination of Capitol's claims in state court.

VI

The order granting summary judgment in Case No. 80-4113 is vacated and the case is remanded with directions to enter an order of dismissal on grounds of lack of subject matter jurisdiction.

The order granting summary judgment in Case No. 80-4114 is reversed and the case is remanded.[33]

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[33]Subsequent to oral argument on appeal, Capitol and EMI moved to stay the proposed assessment, pursuant to Fed. R. App. P. 27(b), pending a final determination of these cases by this court or by the district court on remand. In view of our ruling with respect to Case No. 80-4113, the motion to stay is moot as to that case. Whether the proposed assessment should be stayed with respect to Case No. 80-4114 should be considered in the first instance by the district court on remand. *See* note 32 *supra*. Therefore, appellants' motion to stay the proposed assessment is denied. We express no opinion, however, as to whether the district court should grant such a stay.

Appendix C

Judicial Code Sections.

Section 1331.

(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States, except that no such sum or value shall be required in any such action brought against the United States, any agency thereof, or any officer or employee thereof in his official capacity.

Section 2202.

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1954 [26 USC § 7428], any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

United States Constitution:

Article I, § 8, Cl. 3.

Power of Congress to regulate Commerce.

To regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Art I, Section 10, Cl 1

No State shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money;

emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

Art I, Sec. 10, Cl 2

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.

Art I, Sec. 10, Cl 3

No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

Sec. 2, Cl. 2. Treaties

He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consult, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law:

but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Court of Law, or in the Heads of Departments.

Art I, Sec. 8, Cl. 1

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the Common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

Art I, Sec. 8, Cl 10

To define and punish Piracies and Felonies committed on the High Seas, and Offenses against the Law of Nations.

Art III, Sec. 2, Cl 1

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority, —to all Cases affecting Ambassadors, other public Ministers and Consuls; —to all Cases of admiralty and maritime Jurisdiction; —to Controversies to which the United States shall be a Party; —to Controversies between two or more States; —between a State and Citizens of another State; —between citizens of different States, —between citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens of Subjects.

Art VI, Cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the

United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Amendment 14 Sec. 1

. . . nor shall any State deprive any person of life, liberty, or property, without due process of law

Appendix D

Relevant Sections, United States-United Kingdom Income Tax Convention of 1946.

Article I.

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States of America: the Federal income taxes, including surtaxes (hereinafter referred to as 'Unitd States tax');

(b) In the case of the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the corporation tax, and the capital gains tax (hereinafter referred to as 'United Kingdom tax').

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequent to the date of signature of the present Convention by the government of any territory to which the present Convention is extended under Article XXII."

Article II.

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii and the District of Columbia.

(b) The term "United Kingdom" means Great Britain and Northern Ireland, excluding the Channel Islands and the Isle of Man.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting

Party" mean the United States or the United Kingdom as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

(e) The term "United Kingdom corporation" means any kind of juridicial person created under the laws of the United Kingdom.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" mean a United States corporation or a United Kingdom corporation as the context requires.

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purpose of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which

is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

* * *

Article III.

(1) Industrial or commercial profits of an enterprise of one of the Contracting Parties shall be exempt from tax by the other Party unless the enterprise is engaged in trade or business in the territory of such other Party through a permanent establishment situated therein. If such enterprise is so engaged, tax may be imposed by such Party on the industrial or commercial profits of the enterprise but only on so much of them as are directly or indirectly attributable to the permanent establishment.

(2) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

Appendix E

(Appendix C to Letter of Transmittal of the Third Protocol to the Senate on April 12, 1979)

[43] APPENDIX C (to Letter)

WRITTEN RESPONSES BY WITNESSES TO QUESTIONS BY SENATORS AND COMMITTEE STAFF

Department of The Treasury
Washington, D.C.
June 8, 1979.

HON. FRANK CHURCH
Chairman,
Committee on Foreign Relations,
U.S. Senate
Washington, D.C.

DEAR MR. CHAIRMAN: To follow-up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again, let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

Enclosures.

QUESTIONS FOR ASSISTANT SECRETARY FOR TAX POLICY DONALD C. LUBICK

* * * * *

[45] Questions 6 and 7. In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the proposed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration and exploitation connection activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the perma[46]nent establishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any refer-

ence to "an installation of drilling rig or ship used or the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists, that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought

specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

THIRD PROTOCOL TO THE U.S.-U.K. INCOME TAX TREATY:

Question 1. Would you please summarize the British reaction to the reservation included in the Senate advice and consent to ratification last June 27, 1978, concerning Article 9(4).

Answer. The British tax authorities were unhappy with the Senate reservation concerning Article 9(4). They hoped that a modified version of Article 9(4) might be included in the treaty. When it became clear that there was no possibility of a modification which would be acceptable to all parties, they reluctantly agreed to seek Parliamentary approval of the treaty with the deletion of Article 9(4) but only after the Third Protocol is approved by the Senate. The British authorities view some of the provisions of the Third Protocol (particularly the North Sea permanent establishment rules) as a concession for the deletion of Article 9(4). We recently reconfirmed with the British their willingness to go forward with the treaty if the protocol is approved by the Senate.

[47] Very strong objection has been raised by the United Kingdom business community to the deletion of

Article 9(4). Many business and industrial groups in the United Kingdom have urged Parliament not to reapprove the treaty in the absence of the Article 9(4) provision.

The strength of these objections was confirmed by testimony at the June 6 hearings to the effect that there is a view among some Conservative Members of Parliament that the treaty should not be approved unless some solution can be found to the state taxation problem, albeit outside the treaty framework.

Question 2. Would any reservations added at this date jeopardize the Third Protocol and/or the US/UK Income Tax Treaty? If yes, please explain.

Answer. In our judgment any reservation on the Third Protocol, or any substantial delay in approval of the Protocol will seriously jeopardize the chances that the proposed US/UK Income Tax Treaty, with its very substantial benefits for U.S. taxpayers, will ever come into effect.

While we cannot speak for the United Kingdom, or predict with absolute certainty the actions which might be taken by the British Parliament, certain facts are clear. There is strong business opposition in the United Kingdom to the treaty reservation on Article 9(4) and as time passes there is also likely concern over the growing cost of the retroactive refund to the U.S. investors of the British Advance Corporation tax (it will be over $500 million through 1979). Despite this, the British have agreed to go forward to Parliament with the treaty as long as the U.S. Senate approves the Third Protocol containing what we, and they, view as a reasonable and justifiable provision clarifying the United Kingdom's taxing rights over certain offshore activities.

Should the United States again reserve on a treaty provision important to the British, particularly one which is reasonable in light of both the domestic tax law of the United States and the history of the basic treaty, it may well provide sufficient impetus for those in the United Kingdom opposed to the treaty to secure its defeat. Prolonged delay could have a similar effect.

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